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PENNSYLVANIA BUSINESS SURVEY

College of Business Administration The Pennsylvania State University June 1987

ECONOMIC SITUATION REMAINS UNCHANGED IN APRIL

April brought with it no clear signals of any deviation from recent economic trends in Pennsylvania. Hence, **as has been the case for the past several months, a number of adjectives may be used to describe economic growth in the Commonwealth: modest, moderate, sluggish, muddling, slow, etc.** However, it should be pointed out that opinions do differ concerning the economy's strength. Analysts focusing on southeastern Pennsylvania or on job trends in nonmanufacturing establishments are probably quite encouraged. Just the opposite is probably true for those examining the situation throughout much of the rest of the Commonwealth or the job picture in manufacturing.

Furthermore, differing results may also be arrived at using different sets of data. For instance, two different measures of job and employment trends, each using a different sample, are often cited, one based on a sample of nonagricultural establishments and one based on a sample of residents. The nonagricultural data show a 2 percent job gain in these establishments in Pennsylvania during the first four months of this year. The resident survey shows a decline of 0.2 percent in the number of Pennsylvanians counted as employed. In sum, it appears that the positives slightly outweigh the negatives, resulting in an economy moving forward, but at a pace that is somewhat less than satisfactory.

This is essentially the same scenario which is transpiring at the national level. Assuming this trend continues in the U.S. as a whole, **it is quite unlikely that Pennsylvania economic conditions will improve considerably anytime soon** given that the Commonwealth is heavily influenced by economic trends in the nation.

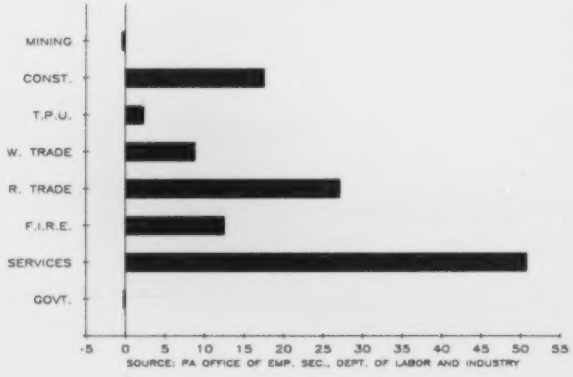
Job trends in Pennsylvania remained unchanged during April as most service-producing and construction industries continued adding workers and in many cases, operated with a record high number of employees. On the other hand, the job situation in manufacturing remains worrisome.

Within the nonmanufacturing sector, **the service-producing industries have been generating a significant amount of jobs as of late.** Especially encouraging performances have been turned in by the services, trade, and finance-related industries. **Services establishments added more than 50,000 jobs during the first four months of this year compared to a year ago** (see chart). Job levels in this industry have advanced to a new record in each of the past 28 months after adjustment for normal seasonal trends, including a seasonally adjusted gain of 11,000 in April to 1.26 million.

Although wholesale trade job levels dipped slightly during April, **the trade industries in Pennsylvania, both wholesale and retail, have contributed greatly to overall job growth in the Commonwealth.** The monthly decline in wholesale trade jobs was the first since June 1986 and only the second since November 1985 after normal seasonal trends are discounted. The 266,900 workers in these industries translate into the third highest level on record, trailing only March's 268,000 and February's 267,300.

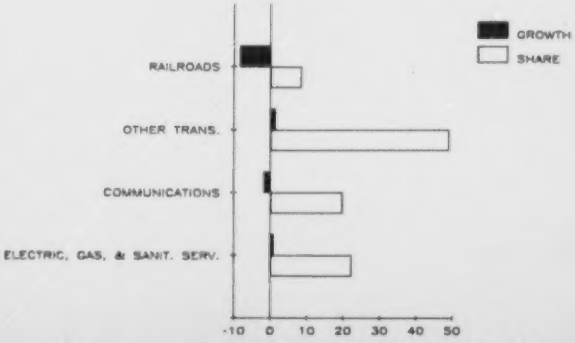
The situation is even more encouraging in the retail trade area where a seasonally adjusted 858,400 jobs were maintained in April, up 2,800 from the previous month. Employ-

PA NONMANUFACTURING JOB GROWTH BY INDUSTRY, 1986 YTD-1987 YTD
(thousands)



SOURCE: PA OFFICE OF EMP. SEC., DEPT. OF LABOR AND INDUSTRY

TRANS. AND PUBLIC UTILITIES INDUSTRIES IN PA: 1985-1986 JOB GROWTH AND 1986 JOB SHARES
(percent)



SOURCE: U.S. DEPT. OF LABOR, BUR. OF LABOR STATS.

ment in this industry has increased nonstop since February 1986 and has remained at an all-time high since May of last year.

In the finance, insurance, and real estate category, there were 12,550 more jobs during this year's first four months compared to the same period in 1986. Job levels have increased for 27 consecutive months, including a seasonally adjusted gain of 1,400 in April to 286,500, a record high.

One exception to this rather encouraging overview of the service-producing sector is found in the transportation and public utilities industries where minimal job gains have been recorded so far this year. (The accompanying chart provides an overview of the industries which make up this category.)

Elsewhere in nonmanufacturing, **the job picture in construction remains bright.** At a seasonally adjusted 219,700, there were a record number of constructon jobs in April in Pennsylvania. The total for March was 211,800. Construction activity normally picks up in the warm-weather months. In fact, there are usually about 15,500 jobs added in the industry during April as a result of these seasonal trends. This past April, 23,400 jobs were added, resulting in the seasonally adjusted gain of 7,900.

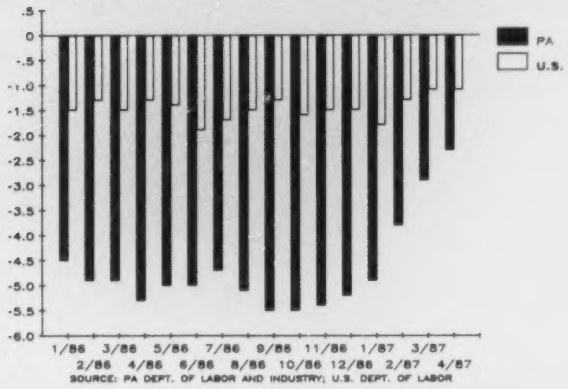
However, **recent behavior in the value of construction contracts awarded has been relatively sluggish.** So far this year, awards are up 5.3 percent compared to a year ago. During the same period in 1986, the annual gain was 42.9

Economic Activity in Pennsylvania	UNADJUSTED DATA			SEASONALLY ADJUSTED DATA			SEASONALLY ADJUSTED INDEXES (1977 = 100)		
	1987		1986	1987		1986	1987		1986
	Mar.	*Apr.*	*Apr.*	*Mar.*	*Apr.*	*Apr.*	*Mar.*	*Apr.*	*Apr.*
Pennsylvania Industries									
All nonagricultural industries									
No. of wage and salary jobs (thous.)[1]	4,807	4,880	4,775	4,866	4,883	4,778	106.6	107.0	104.6
Nonmanufacturing									
No. of wage and salary jobs (thous.)	3,774	3,843	3,720	3,828	3,845	3,723	118.8	119.3	115.5
Mining	31*	32	34	32*	32	34	66.9*	66.2	71.4
Contract construction	188	212	193	212	220	201	115.1	119.4	109.4
Transportation	137	138	139	138	137	138	86.0	85.1	86.0
Public Utilities	104	105	101	105	105	101	104.0	104.7	100.7
Wholesale trade	266	266	258	268	267	259	120.9	120.4	116.6
Retail trade	834	848	818	856	858	828	119.3	119.7	115.5
Finance, insurance & real estate	282	285	273	285	287	275	131.1	131.7	126.2
Service & miscellaneous	1,240	1,264	1,212	1,248	1,259	1,207	144.7	145.9	139.9
Federal government	139	139	140	139	139	140	108.2	108.4	109.0
State & local government	553	554	552	544	544	541	93.3	93.3	92.9
Manufacturing									
No. of wage and salary jobs (thous.)	1,032	1,036	1,052	1,038	1,038	1,055	77.4	77.4	78.6
Durable goods	584	588	602	588	588	602	72.7	72.6	74.3
Nondurable goods	448	448	451	450	450	453	84.5	84.6	85.1
Ave. wkly. hrs. worked by prod. workers	40.6	40.0	39.9	40.5	40.2	40.1	102.6	101.8	101.5
Total wkly. person-hours worked (mils.)	28.3*	28.1	28.5	28.5*	28.3	28.7	74.2*	73.8	74.6
Total wkly. payroll (mil. dols.)	279.0*	278.9	276.5	280.4*	280.5	278.1	124.8*	124.9	123.8
Steel production (thous. tons)	895	1,033	1,067	n.a.	n.a.	n.a.	34.2	40.0	41.6
Industrial electric power sales (mil. kwh)	3,534	3,453	3,433	3,471	3,457	3,443	94.0	93.6	93.2
Mining									
Anthracite coal (thous. net tons)	389	363	300	421	458	383	86.3	93.9	78.5
Bituminous coal (thous. net tons)	5,233	n.a.	5,350†	5,017	n.a.	5,130†	71.1	n.a.	72.7†
Construction contracts awarded (mil. dols.)									
Total	1090.6	722.3	893.0*	1138.8	598.5	732.9*	354.0	186.0	240.4*
Residential building	363.9	320.1	420.0*	365.0	245.8	336.2*	259.3	174.7	238.9*
Nonresidential building	475.1	229.5	232.4*	548.2	225.9	226.7*	505.3	208.2	209.0*
Nonbuilding (utilities and public works)	251.6	172.7	240.6*	225.6	126.8	170.0*	311.3	126.8	234.4*
Employment of Pennsylvania Residents									
Employed, no. of persons (thous.)	5,106	5,164	5,214	5,199	5,236	5,294	108.2	109.0	110.2
Unemployed									
No. of persons (thous.)	340	295	393	325	306	404	81.0	76.3	100.7
Rate (percentage of labor force)	6.2	5.4	7.0						
Rate, seasonally adjusted				5.9	5.5	7.1			
Civilian labor force, no. of persons (thous.)	5,446	5,459	5,607	5,524	5,542	5,698	106.1	106.4	109.4
Initial claims for unemployment benefits	81,084	92,138	107,352	97,327	98,661	113,213	68.0	68.9	79.1

Consumer Prices, all items	Urban Indexes (1967 = 100) 1987		1986	Percentage Change	
	Mar.	*Apr.*	*Apr.*	*Month Ago*	*Year Ago*
U.S. city average	335.9	337.7	325.3	+0.5	+3.8
Philadelphia	329.4	333.8	317.8	+1.3	+5.0
Pittsburgh	n.a.	338.2	328.1	n.a.	+3.1

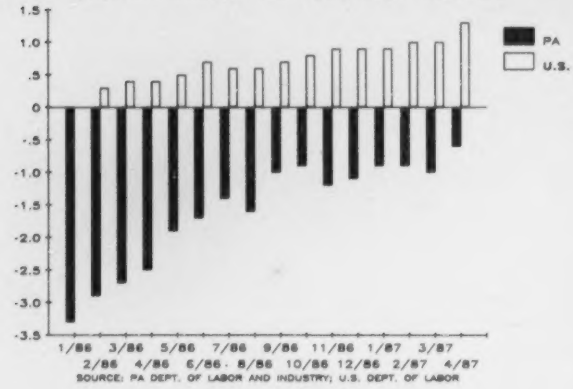
[1] Total includes workers on strike. * = figure revised † = figure for March 1986 n.a. = data not available
SOURCES AND DEFINITIONS OF DATA ARE AVAILABLE ON REQUEST.

PA AND U.S. DURABLE GOODS JOB GROWTH
(percent change from year-ago month)



SOURCE: PA DEPT. OF LABOR AND INDUSTRY; U.S. DEPT. OF LABOR

PA AND U.S. NONDURABLE GOODS JOB GROWTH
(percent change from year-ago month)



SOURCE: PA DEPT. OF LABOR AND INDUSTRY; U.S. DEPT. OF LABOR

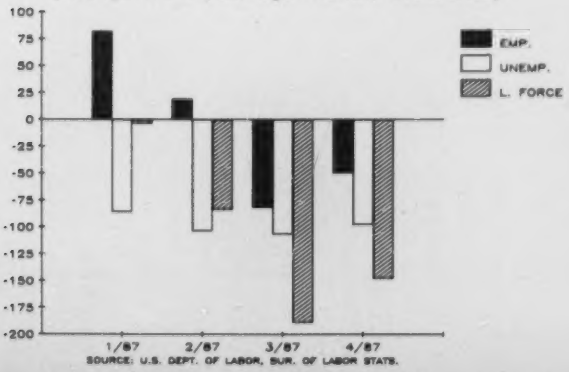
percent. Much of the growth that has occurred so far this year has been in the nonresidential building category where awards are up by more than one-quarter in value. Contract values for residential projects are up less than 2 percent while those for nonbuilding projects are down 12.5 percent.

Some analysts contend that too much attention is given to the manufacturing sector in Pennsylvania when analyzing economic conditions in the Commonwealth. **While it may be true that the State is becoming more and more dependent on nonmanufacturing for new jobs, the fact remains that, in relative terms, manufacturing industries are more important to the health of the Pennsylvania economy than to the U.S. as a whole.** Certainly, some of the problems facing the manufacturing sector are beyond the control of individual states, such as the problems associated with intense competition from abroad, but a disturbing trend remains which shows that the manufacturing job situation is worse in Pennsylvania than in the nation.

As shown in the accompanying charts, **job losses in Pennsylvania's durable goods manufacturing establishments have been more than twice as large as in the nation for the past several months. On the nondurables side, while the U.S. has been showing slight job gains, Pennsylvania has shown consistent losses.**

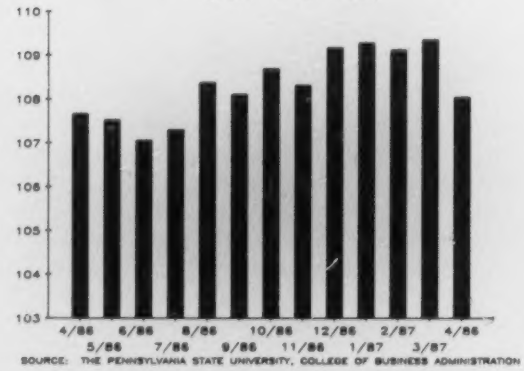
At a seasonally adjusted 1.04 million, the number of manufacturing jobs in April remained unchanged from the previous month. The trend in manufacturing jobs, though, is

PA EMPLOYMENT, UNEMPLOYMENT,
AND LABOR FORCE GROWTH
(change from year-ago month; thousands)



SOURCE: U.S. DEPT. OF LABOR, BUR. OF LABOR STATS.

PENNSYLVANIA COMPOSITE INDEX
OF LEADING INDICATORS
(Jan 1972=100)



SOURCE: THE PENNSYLVANIA STATE UNIVERSITY, COLLEGE OF BUSINESS ADMINISTRATION

still definitely downward. Other indicators of manufacturing's health such as the average factory workweek, total hours worked, total payrolls, and electricity sales to industry held fairly steady within narrow ranges. Steel production rose again, probably as a result of increased activity on the part of USX in the aftermath of their labor agreement.

There was some welcome news on the employment and unemployment front during April. **Employment rose for only the third time in the past eight months and the labor force rose for only the second time over the same period.** Still, the improvements were very slight, especially in light of the error ranges associated with the data. The jobless rate fell from 5.9 to 5.5 percent, seasonally adjusted.

The accompanying chart shows that a good deal of the improvement in the unemployment situation in Pennsylvania as of late is the result of declines in the labor force. In fact, **although unemployment was down, employment of Pennsylvania residents in March and April fell below year-ago levels. Clearly, the decline in the jobless rate so far this year is not the result of an especially strong employment picture.**

There was a strong decline of 1.3 percent in the Pennsylvania index of leading indicators in April. The decline was heavily influenced by a steep drop of 47 percent in the value of construction contract awards. The two remaining components of the index, the average factory workweek and initial claims for unemployment benefits, worsened only slight-

ly. Additionally, the index of coincident indicators, which measures the trend in current economic activity, fell for the third consecutive month.

— *William D. Anderson*

A Note of Thanks

Many individuals and organizations outside of The Pennsylvania State University make significant contributions to the success of the *Pennsylvania Business Survey*. Without their cooperation, publication of the *Survey* would be much less timely and the analyses would be severely limited.

Pennsylvania's Department of Environmental Resources and the U.S. Department of Energy supply the data on coal output in the Commonwealth. The American Iron and Steel Institute provides information on steel production. The importance of the mining and steel industries to the Pennsylvania economy are well-documented. The data supplied by these organizations allow us to examine and interpret trends in these industries.

Electricity consumption on the part of industry in Pennsylvania provides an indication of production trends in the Commonwealth and plays a major role in our evaluation of overall economic trends. Without the help of several utilities across the State who supply us with data concerning their sales of electricity to industrial customers, this important part of our evaluation would not otherwise be available.

Because of the importance of employment and job trends in interpreting economic conditions at the State and local levels, the cooperation of the Philadelphia office of the U.S. Bureau of Labor Statistics and the Research and Statistics Division of the Pennsylvania Department of Labor and Industry deserves special thanks. Each of these offices tolerate countless phone calls each month as we update our information and check the accuracy of the data and have become instrumental to the success of our program. Additionally, some of the Department of Labor and Industry's local labor market analysts have offerred some very helpful comments and advice concerning the "Around the State" section of the *Survey*.

Again, we offer our thanks to all who have helped with the publication of the *Pennsylvania Business Survey*. We look forward to continuing our relationships in the future.

Personal Income Report

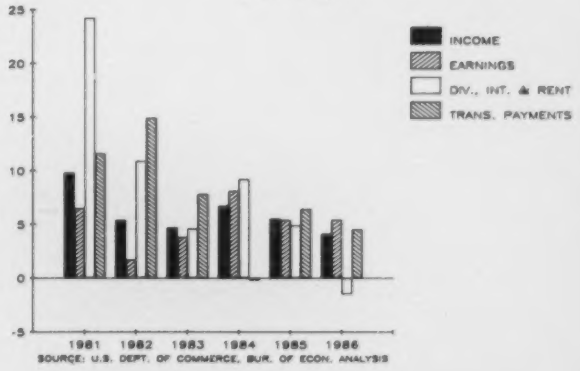
Personal income trends in Pennsylvania during 1986 provide further evidence of an economy showing modest growth, but with considerable room for improvement. For the entire year, personal income, which represents income from all sources, totalled $165.8 billion in the Commonwealth for a gain of 4.1 percent from 1985. Nationwide, the increase was 5.3 percent to nearly $3.5 trillion. On the plus side, these gains outpaced price increases, which implies a "real" or inflation-adjusted gain and a corresponding increase in buying power.

All of last year's growth in personal income in Pennsylvania occurred in two components: earnings and transfer payments (see chart). Income from the third component, dividends, interest, and rent (DIR), fell from 1985 levels. Wages and salaries make up the bulk of the earnings category. During 1986, they grew 4.8 percent. Given that nonagricultural job levels expanded by 1.4 percent, this suggests that unit labor costs, a good barometer of inflationary pressures, grew only moderately, a trend in line with national patterns. Growth in income derived from the DIR category has declined considerably since the early 1980s, partially the result of lower interest rates and hence, income from financial instruments.

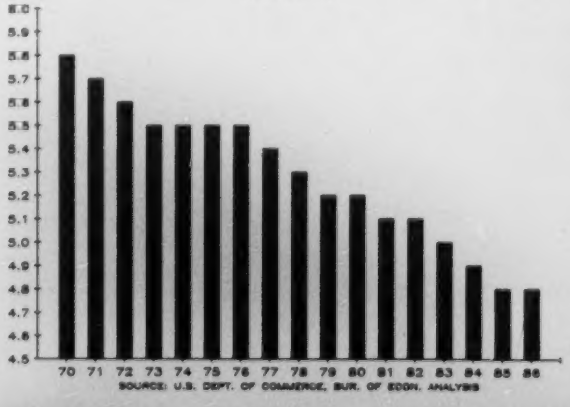
Unfortunately, as stated several times in the past, it does not appear as if economic growth in Pennsylvania is keeping pace with that in the nation. Personal income growth in the Commonwealth failed to match the national rate of increase for the twelfth consecutive year. As shown in the accompanying chart, Pennsylvania's share of U.S. personal income has been on the decline over the past several years. Pennsylvania accounted for about 4.8 percent of U.S. personal income in 1986. In 1970, the figure was 5.8 percent.

Additional evidence of Pennsylvania's relatively weak showing as of late may be found in the per capita (per person) personal income (PCPI) data. Pennsylvania PCPI was nearly identical to that for the nation throughout the early

ANNUAL GROWTH IN PA PERSONAL INCOME AND ITS COMPONENTS
(percent)



PA PERSONAL INCOME AS A SHARE OF THE U.S.
(percent)



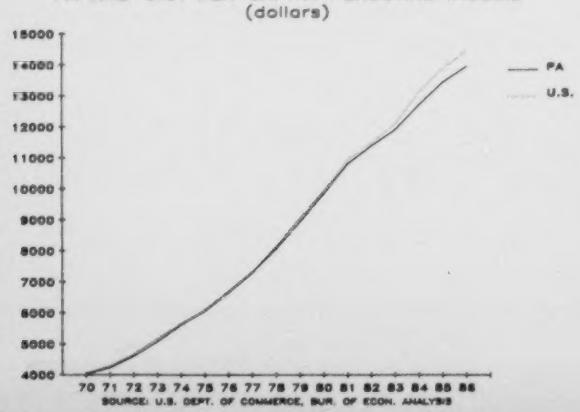
1986 Personal Income by Major Source, Pennsylvania and the United States
(Millions of Dollars)

	Pennsylvania		U.S.
	1986	Pct. Chg. From 1985	Pct. Chg. From 1985
Labor and proprietors income by place of work	117,722	5.4	6.1
By type			
Wage and salary disbursements	94,337	4.8	5.5
Other labor income	10,357	5.1	6.0
Proprietors income	13,027	9.9	10.6
By industry			
Farm	794	- 6.6	- 1.1
Nonfarm	116,928	5.4	6.2
Private	101,500	5.6	6.2
Ag. serv., for., fish., and other	437	16.5	10.0
Mining	1,567	- 8.4	-13.3
Construction	7,577	17.6	10.1
Manufacturing	29,510	- 0.4	2.5
Nondurable goods	11,200	2.8	3.7
Durable goods	18,310	- 2.3	1.8
Transportation and public utilities	8,227	3.2	3.3
Wholesale trade	7,035	5.3	4.2
Retail trade	11,343	7.2	5.6
Finance, insurance, and real estate	7,580	15.8	15.7
Services	28,227	7.9	8.9
Government	15,427	4.3	6.5
Federal, civilian	3,889	2.7	2.8
Federal, military	626	- 1.0	4.8
State and local	10,913	5.2	8.0
Total personal income	165,774	4.1	5.3
Nonfarm personal income	164,980	4.1	5.4
Net labor proprietors income[1]	109,232	5.4	6.1
Dividends, interest and rent	26,273	- 1.5	1.9
Transfer payments	30,269	4.5	5.6

SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis.
Regional Economic Information System, April 1987.
[1]Total earnings by place of work less personal contributions for social insurance and plus an adjustment for residence.

and mid 1970s. However, beginning in the late 1970s, the nation began to open up a gap with respect to the Commonwealth (see chart). As of 1986, PCPI in Pennsylvania

PA AND U.S. PER CAPITA PERSONAL INCOME
(dollars)



came to $13,944 compared to $14,461 in the nation as a whole.

In terms of PCPI, the Commonwealth's position began to deteriorate just about the time manufacturing started suffering from a number of structural problems. As shown in the accompanying chart, a much larger share of nonfarm earnings in Pennsylvania comes from the manufacturing sector compared to the U.S. (25.3 percent vs. 21.7 percent). Hence, problems in these industries are magnified in the Commonwealth. On the private sector service-producing side, the share of total earnings in Pennsylvania and the nation is about the same at 53.6 percent and 54 percent, respectively.

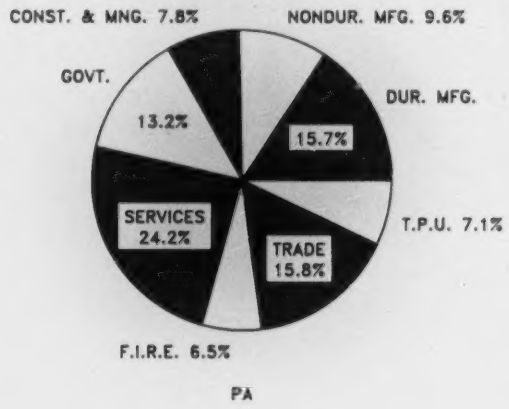
In looking at the situation on an industry-by-industry basis, the 1986 data provide a clear indication of the problems caused by manufacturing's difficulties. Although total nonfarm earnings in Pennsylvania grew by 5.4 percent compared to 6.2 percent in the U.S., in several service-producing industries within the Commonwealth, earnings growth was quite similar to national growth, and in many cases, exceeded

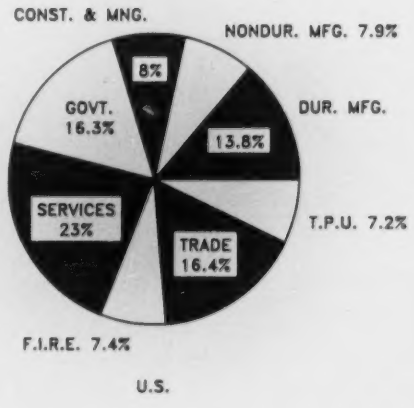
it. On the goods-producing side, the decline in mining earnings in Pennsylvania was not as large in the U.S., while the gain in construction earnings was considerably stronger. Clearly, the bulk of our problems may be traced to the manufacturing sector where earnings fell 0.4 percent last year compared to a 2.5 percent gain in the nation.

— *William D. Anderson*

(Normally, personal income estimates for metropolitan areas are also presented at this time. However, because of a comprehensive revision program, the Bureau of Economic Analysis will not be releasing this information this year. Next spring, both 1985 and 1986 estimates will be released.)

PA AND U.S. 1986 NONFARM EARNINGS DISTRIBUTIONS
(by place of work; percent)





SOURCE: U.S. DEPT. OF COMMERCE, BUR. OF ECON. ANALYSIS

THE U.S. ECONOMY . . . A DELICATE BALANCE THREATENED

(Although the focus of the *Survey* is clearly on economic conditions in the Commonwealth, it is important to keep in mind that national trends are quite important to the health of the State economy. Hence, it is beneficial to periodically review trends in the U.S. as a whole. This article was prepared by Jack Malehorn, Economist for United Telephone System, Eastern Group. The views expressed are his own and do not necessarily reflect those of United Telephone System or The Pennsylvania State University.)

Despite a strong first quarter, the delicate balance which has characterized the U.S. economy over the last several quarters appears to be in jeopardy. A falling dollar, rising interest rates and inflationary pressures have sparked widespread concern over the economy's resiliency. Whether this is the first warning sign of an impending downturn is too early to tell. More than likely, the economy will rebound in a continuation of its earlier roller-coaster style, characterized by seemingly conflicting economic signals. While the risk of a recession has increased, odds are that the economy will finish the year with positive, albeit contained, growth.

First Quarter Results

The economy recorded a surprising 4.4 percent annual rate of increase in real GNP during the first quarter of the year. The first quarter results are the strongest since the second quarter of 1984, and above the 2.4 percent average annual rate of increase recorded since mid 1984. The principal reason for the first quarter improvement was linked to inventory spending and an increase in net exports.

While on the surface the first quarter results gave reason for optimism, several underlying factors emerged which signalled caution. The strong inventory buildup was due mainly to farm stocks and automobiles. Only a small portion of the nonfarm inventory increase was in nonautomotive goods, suggesting that inventories are still expected to remain lean. In fact, excluding inventory growth, GNP actually declined 2 percent in the first quarter.

Net exports rose for the second successive quarter due to a reduction in imports, particularly petroleum products. According to a Federal Reserve Bank of Cleveland publication entitled, *Economic Trends*, the increase in real net exports of goods and services contributed more than one-third of the first quarter's growth. As anticipated, consumer spending, business spending and residential spending fell in the first quarter.

The Consumer

Earlier this year, projections for consumer spending growth called for something substantially less than the previous year's robust performance. The central issue today focuses on whether the consumer has begun a retrenchment or, instead, a temporary pause. Total personal consumption expenditures

increased a mere 0.4 percent on an annualized basis in the first quarter. Nondurable goods and services exhibited a 1.2 percent and 4.3 percent increase, respectively. However, the more volatile durable goods component fell 18 percent. A major factor in the durable goods decline was a reduction in automobile sales. Still, purchases of durable goods reflect consumer attitudes and their willingness and ability to purchase big ticket items and service long-term debt. High debt to income levels, changes in the tax laws and historically low savings support the forecast of a reduction in consumer expenditures. Of greater consequence is the consumer's responsiveness to recent price pressures and rising interest rates. Most assuredly, consumer confidence is on the wane, affected in part by a loss of real purchasing power. This dual blow of higher inflation and an increase in interest rates could stymie consumer intentions throughout the remainder of the year.

Business

As previously noted, the first quarter strength in the economy was mainly the result of stockpiling. Therefore, a reassessment of the business sector's fortunes is still premature. Factory operating rates remain at low levels and global demand for goods is low. Vacancy rates for office complexes and shopping centers remain high enough to thwart speculative intentions of building for the next boom period. Finally, businesses now face rising interest rates in the face of uncertain markets.

American businesses are intent upon improving the bottom line. Consequently, cost-saving techniques such as labor force reductions, the writing down of unproductive facilities, slashing overhead costs, selling assets and restructuring operations are currently in vogue. A conservative approach to investment opportunities (i.e., plant and equipment spending), will be considered the norm throughout the year.

Trade

The bright news in the first quarter GNP report is that the foreign trade deficit declined on an annualized basis. A closer examination indicated that the reduction in the trade gap was principally due to less oil imports. Despite the decline in the dollar, it is still a risk to assume that U.S. exports will increase enough to offset the unrelenting foreign trade deficit. Foreign goods have become deeply entrenched in U.S. markets and are not expected to be replaced by domestically manufactured goods immediately. Finally, uncertainty exists concerning whether U.S. producers can enter or regain foreign markets with the currently available sales force and marketing techniques.

Financial Markets

Sparked by the fear of a freefall in the dollar and inflationary pressures, turbulence rocked the financial markets. In effect, an increasingly tight linkage exists between foreign exchange markets and the bond market. The realization that the U.S. cannot borrow on an unlimited basis without influencing the exchange value of its currency, kindling fears of inflation, and causing worries over the economy's performance, has pervaded credit markets. Rapid depreciation in the value of the dollar against other currencies has fueled an erosion in confidence by market participants and consequently has caused a reduction in bond prices. As a result, yields on long-term treasury securities and mortgages rose as did short-term rates, although not as substantially. Over a matter of a few weeks, long-term treasury securities and mortgages advanced from 100 to 200 basis points, practically wiping out the previous year's declines.

The task facing the Federal Reserve System has become even more cumbersome. Cognizant of inflationary pressures within the economy, the Fed could force interest rates higher in order to contain price pressures, but only at the risk of worsening the foreign debt crisis and possibly pushing the economy to the brink of a recession. On the other hand, an attempt to lower interest rates would clash with the Treasury's task of financing the federal budget deficit. The fear of foreign investors balking at dollar denominated securities maintains a constant floor under interest rates and makes a push for lower rates by the Fed highly unlikely.

Inflation

The fear of inflation — virtually dormant over the last several years — reemerged with sudden force. Credit and equity markets turned extremely volatile, being pushed and pulled by reports on the dollar and precious metal prices (a barometer of basic inflationary pressures). Over the first quarter, the Consumer Price Index grew at a compound rate of 6.2 percent compared to last years's 1.1 percent advance. The Producers' Price Index (a barometer of wholesale goods inflation) increased 4.6 percent on an annual compound basis as compared to a 2.5 percent decline in 1986.

At this stage in the business cycle, inflation is usually the result of production limitations and/or wage pressures. However, the current increase in prices is more closely tied to the foreign sector with little evidence of capacity constraints within the economy. The fall in the dollar has led to a subsequent increase in import prices as a means by which foreign producers can enhance profit margins. In addition, domestic producers appear to have responded with their own increase in prices, foresaking the opportunity to gain back market-share.

An examination of the components which make up the CPI indicates that energy prices were the main contributor to the first quarter's price pressures. In addition, prices for housing, transportation, medical care, entertainment and other goods and services increased. For a period of over a year, the goods component of inflation was subdued. Now with import and domestic price increases, combined with service price pressures, inflation has become more deeply entrenched. Of special concern is the possibility of an inflation spiral developing which feeds on itself through speculative buying practices.

The key question surrounding the reemergence of inflation is the economy's sensitivity to rising prices and subsequently higher interest rates. Either one or both combined could be enough to derail the economy.

New Rules and a New Game

The decade of the sixties was marked by a high growth period fueled by the Kennedy/Johnson Administration's Great Society programs and the war effort. During that time, the U.S. economy was firmly established as an engine to the world economy and the benchmark by which the rest of the world could judge their nation's economic performance. The decade of the seventies witnessed several major supply shocks (i.e., oil and agricultural goods), and a fierce battle with inflation which reduced the decade's overall growth.

The decade of the eighties may be regarded as the realization of a global economy. Merchandise trade deficits, the value of the dollar, and foreign investment are as much a part of today's environment as the Dow Jones Index. Undoubtedly, the introduction of new global players and worldwide information complicates the analysis of the economy. These changes are reflected in the awareness and level of importance placed on overseas economies. For example, one economist has written that the next downturn in the U.S. economy may not be due to a domestic occurence, but instead a major correction in the Japanese stock market.

Within a relatively short time period, several major problems in the economy have emerged with enough force to significantly impact credit and equity markets and the assurance that the recovery will continue on indefinitely. The value of the dollar, inflation and interest rates have become intricately linked, thereby increasing the sensitivity of many U.S. industries to domestic and international events. In addition, the intractable foreign trade deficit and ominous federal budget deficit continue to weigh heavily on the direction of the economy.

The recovery should remain on track, yet jostled by the now familiar up-and-down pattern experienced over the last couple of years. However, the chances of the recovery continuing through 1988 are more tenuous due mainly to factors outside of the direct control of the U.S. economy and its policymakers.

— *Jack Malehorn*

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